Supreme Court, U.S.
FILED

95-692 OCT 30 1995

No. OFFICE OF THE CLERK

In The

Supreme Court of the United States

October Term, 1995

LAWRENCE INDUSTRIES, INC.,

Petitioner,

v.

JOHN SHARP, COMPTROLLER OF PUBLIC ACCOUNTS OF THE STATE OF TEXAS, et al.,

Respondents.

Petition For A Writ Of Certiorari To The Texas Supreme Court

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the assessment of the Texas franchise tax violated the requirements of due process for lack of fair notice to the out-of-state corporate taxpayer that it would be subject to the tax.

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OPINIONS BELOW

The decision of the Texas Supreme Court denying Petitioner's Application for Writ of Error App. 23 is not reported. The opinion of the Court of Appeals App. 6 is reported at 890 S.W.2d 886 (Tex. App. – Austin 1994). The judgment of the trial court is not reported App. 1.

JURISDICTION

On August 1, 1995 the Texas Supreme Court denied Petitioner's Application for Writ of Error. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1257.

CONSTITUTIONAL, STATUTORY, AND REGULATORY PROVISIONS INVOLVED

U.S. CONST. amend. XIV, § 1:

Section 1. Citizens of the United States.

All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

TEX. TAX CODE ANN. § 171.001 (Vernon 1992):

> § 171.001. Tax Imposed
>
> (a) A franchise tax is imposed on:
>
> (1) each corporation that does business in this state or that is chartered or authorized to do business in this state, . . .

TEX. BUS. CORP. ACT art. 8.01B (Vernon 1980):

> B. Without excluding other activities which may not constitute transacting business in this state, a foreign corporation shall not be considered to be transacting business in this state, for the purposes of this Act, by reason of carrying on in this state any one (1) or more of the following activities:
>
> (1) Maintaining or defending any action or suit or any administrative or arbitration proceedings, or effecting the settlement thereof or the settlement of claims or disputes to which it is a party;
>
> (2) Holding meetings of its directors or shareholders or carrying on other activities concerning its internal affairs;
>
> (3) Maintaining bank accounts;
>
> (4) Maintaining offices or agencies for the transfer, exchange, and registration of securities issued by it, or appointing and maintaining trustees or depositaries with relation to its securities;
>
> (5) Voting the stock of any corporation which it has lawfully acquired; . . .

Texas Comptroller of Public Accounts Ruling No. 026.02.12.016 (1975) (repealed):

> 2. A corporation is "transacting" or "doing" business in Texas when it is transacting some substantial part of its ordinary business in Texas. Each case must be decided on its own facts, with determination based on the totality of the corporation's activities within the State. The Texas Business Corporation Act, Art. 8.01, provides a non-exhaustive list of activities which do not constitute transacting business in the State. This ruling contains a non-exhaustive list of activities which constitute transacting or doing business in Texas.

8 Tex. Reg. 3236 (1983), adopting 34 Tex. Admin. Code § 3.406(c)(14) (repealed):

> (c) Some specific activities which constitute doing business in Texas are:
>
> . . .
>
> (14) Holding companies. Maintaining of a corporation's principal place of business in Texas to manage and direct, and/or perform services for subsidiaries or investee corporation.

STATEMENT OF THE CASE

This lawsuit is the appeal of a trial de novo of a franchise tax assessment by the Texas Comptroller of Public Accounts. See TEX. TAX. CODE ANN. § 112.054 (Vernon 1992) (trial de novo). The taxpayer, Lawrence

Industries Inc. ("Lawrence"), contended in the trial court and in the Texas appellate courts that it did not owe franchise taxes for two reasons: (1) that Lawrence was not "doing business" in Texas under the Texas franchise tax statute, and (2) that the assessment of franchise tax violated the requirements of due process because Lawrence did not have fair notice that it would be subject to the tax.

After a bench trial, the trial court rendered judgment (Appendix 1) denying relief, and issued Findings of Fact and Conclusions of Law (Appendix 2) that Lawrence was doing business in Texas, and that the court did not have subject matter jurisdiction over Lawrence's federal due process claim. Lawrence appealed to the Third Court of Appeals in Austin, Texas, which issued an opinion (Appendix 3) on December 21, 1994 affirming the trial court judgment. The opinion found that Lawrence was doing business in Texas, that Lawrence had alleged sufficient claims for due process jurisdiction, and that the tax assessment did not violate due process. The Texas Supreme Court then denied Lawrence's application for writ of error (Appendix 4).

REASONS FOR GRANTING THE WRIT

Introduction

The essential issue is whether taxpayer reliance on legislative and regulatory statements are relevant to a due process "fair warning" analysis. The Texas Court of Appeals held that the language of the statute and regulations is irrelevant to due process, and for this reason, the

decision conflicts with prior decisions of this Court on an important question of federal law.

This petition will discuss the requirements of due process, the primary conduct of Lawrence in the State of Texas, and how the Texas tax statute and regulations did not give Lawrence fair notice that it would be subject to taxation. It should not be the law that corporations are fools if they rely on government regulations to order their affairs.

The Requirements of Due Process

The requirements of due process were recently stated by this Court:

> Due process centrally concerns the fundamental fairness of governmental activity. Thus, at the most general level, the due process nexus analysis requires that we ask whether an individual's connections with a State are substantial enough to legitimate the State's exercise of power over him. We have, therefore, often identified *"notice" or "fair warning"* as the analytic touchstone of due process nexus analysis.

Quill Corp. v. North Dakota, 504 U.S. 298, 312 (1992) (emphasis added). In the taxation context, the taxpayer must have "fair warning that [its] activity may subject [it] to the jurisdiction of a foreign sovereign." *Id.* at 308, *citing, Shaffer v. Heitner*, 433 U.S. 186, 218 (1977) (Stevens, J., concurring). In the personal jurisdiction context, there is a similar purpose to give "a degree of predictability to the legal system that allows potential defendants to structure their primary conduct with some minimum assurance as to where that conduct will and will not render

them liable to suit." *World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286, 297 (1980).

The due process clause demands fair notice in every context. For example, under the vagueness doctrine, a statute violates due process if it does not give a party sufficient notice as to the specific conduct proscribed. *Grayned v. City of Rockford*, 408 U.S. 104, 108 (1972) ("An enactment is void for vagueness if its prohibitions are not clearly defined."); *U.S. v. Nevers*, 7 F.3d 59, 61 (5th Cir. 1993), *cert. denied*, ___ U.S. ___ (1994) (A statute is void for vagueness "when it fails to provide a person of ordinary intelligence fair notice of the conduct it proscribes."); *U.S. v. Wicker*, 933 F.2d 284, 288 (5th Cir. 1991), *cert. denied*, 502 U.S. 958 (1992). Due process thereby demands that a party be given notice of the potential consequences of their actions.

This Court has made it clear that a court, analyzing the scope of due process, must consider not only minimum contacts through the actions of a party, but must independently analyze the reasonableness and fairness of bringing the party within the scope of state regulation. *Asahi Metal Industry Co., Ltd. v. Superior Court of California*, 480 U.S. 102, 114 (1987) (analyzing due process in the context of personal jurisdiction). Even if this Court finds that Lawrence had minimum contacts with Texas, it must still analyze whether imposing franchise taxes upon Lawrence violates traditional notions of fair play and substantial justice.

The basic premise of the fair notice element of due process is this: could the party reasonably have anticipated being subjected to the taxing power of the state?

The Texas Court of Appeals erred when it held that notice, expectations, and reasonable anticipation are not relevant to a due process inquiry. This Court should therefore grant this petition and consider whether Lawrence had reasonable notice that its actions might subject it to Texas franchise taxes. Lawrence did not have reasonable notice if the Comptroller's rules misled it as to which actions would or would not subject it to taxation.

Statement of Key Facts Regarding Lawrence's Activity in Texas

Lawrence is disputing the franchise tax assessed for its accounting year May 1, 1983 through April 30, 1984 (the "audit year"). Statement of Facts at 16. During the audit year, Lawrence was a Delaware holding company, owning stock in subsidiary Delaware corporations, which independently were authorized to do business in Texas, which held their own directors' meetings, and which properly paid franchise taxes to the State of Texas. Statement of Facts at 31-32, 43. The principal subsidiary of Lawrence was Dailey, Inc., doing business as Dailey Petroleum Services Corp., a manufacturer of oil tools. Statement of Facts at 29; Plaintiff's Exhibit 1 (organization chart). During the audit year, Lawrence held a director's meeting in Texas, at which it duplicated the minutes of an earlier board meeting of its subsidiary, Dailey. Statement of Facts at 66-67.

Lawrence was incorporated in 1981 in Delaware and did not have a certificate of authority to do business in Texas during the audit year. Statement of Facts at 33, 35-36; Plaintiff's Exhibit 3 (certificate of withdrawal).

Lawrence did have a certificate of authority to do business in Nevada, where it conducted its active trade and business – a machine shop, which serviced oil tools. Statement of Facts at 34, 39. Lawrence owned no assets in Texas and paid no property taxes in Texas, but Lawrence did own real and personal property in Battle Mountain, Nevada and paid the appropriate business taxes on its assets there. Statement of Facts at 35, 38, 39, 92. Lawrence had no employees in Texas, but Lawrence did have employees in Battle Mountain, Nevada where it conducted its active trade and business. Statement of Facts at 34, 35.

During the audit year, Lawrence received $48,039 in interest from a bank chartered in Texas, but received no dividends from its subsidiaries. Plaintiff's Exh. 6 (Audit Adjustment Report Line 7). The Comptroller recognized that ownership of a Texas bank account did not constitute doing business in the State. Statement of Facts at 121-22. However, for purposes of apportioning taxable capital to Texas based on gross receipts in Texas versus gross receipts elsewhere, the Comptroller apportioned the interest payments to Texas, the state of incorporation of the payor bank. See 34 Tex. Admin. Code § 3.549 (1994). The interest payment represented 74% of Lawrence gross receipts for the year. Plaintiff's Exh. 6 (Audit Adjustment Report Line 9). As a result, the Comptroller apportioned 74% of the capital and surplus of this multi-million dollar corporation to Texas, and imposed a franchise tax of $502,740 based on $48,039 in interest income. *Id.* (Lines 13, 15).

If Lawrence had known it would be subject to Texas franchise taxation, it could have avoided taxation by (a)

holding its directors' meeting in another state, (b) transferring its interest bearing bank accounts to a non-Texas bank, thereby eliminating all Texas receipts, or (c) receiving a substantial dividend from its subsidiary, which would have been treated as a non-Texas receipt. Statement of Facts at 99-100.

The Texas Franchise Tax Statute and Regulations

The Texas franchise tax statute imposes a tax on "each corporation that *does business in this state* or that is chartered or authorized to do business in this state." TEX. TAX CODE ANN. § 171.001 (Vernon 1992) (emphasis added). During the audit year, the statute did not further define what constituted doing business for purposes of the imposition of the franchise tax.[1]

The Texas Supreme Court has held that the phrase "business done in Texas" is ambiguous. *Humble Oil & Refining Co. v. Calvert*, 414 S.W.2d 172, 180 (Tex. 1967).[2]

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[1] Effective January 1, 1992, Texas Tax Code section 171.001 was amended by the addition of subsection (c), which extended the franchise tax to the limits of the United States Constitution. However, section 8.27 of the adopting act provided that the change in the law did not affect the obligation to pay franchise tax for reports due before January 1, 1992. See TEX. TAX. CODE § 171.001 (Vernon 1992) (Historical and Statutory Notes).

[2] The *Humble Oil* case referred to former article 7084 of Vernon's Annotated Texas Statutes, which is now codified in the initial sections of Chapter 171 of the Texas Tax Code, and which imposes the Texas franchise tax on each corporation that "does business" in the State and apportions taxable capital based on "business done" in the State. See TEX. TAX CODE §§ 171.001, 171.103 (Vernon 1992); TEX. TAX CODE Derivation Table

Thus, precedent establishes that "doing business" is an ambiguous phrase when the Texas Tax Code does not address the activity at issue. Moreover, apart from precedent, common sense should lead to the conclusion that such a nebulous phase could be subject to more than one reasonable meaning, and that it offers little real guidance to corporations in structuring their affairs.

Court precedent also fails to fill the void left by the ambiguous statute. During the audit year, there were no reported decisions concluding that a holding company with an active trade or business in another state, but no sales, assets, or employees in the State was nevertheless "doing business" there. In fact, the generalized statements in the cases suggested the contrary – that a corporation would not be "doing business" in the State unless it was conducting substantial and continuous business in Texas:

> The general rule is that, when a foreign corporation transacts some *substantial part of its ordinary business* in a state, *continuous in character*, it is doing, transacting, carrying on, or engaging in business therein, within the meaning of the statutes under consideration.

Ramsey v. Investors Diversified Services, 248 S.W.2d 263, 267 (Tex. Civ. App. – Austin 1952, writ ref'd n.r.e.), quoting Corpus Juris Secundum (emphasis added). Furthermore, it has long been held in Texas that the tax statute must be "strictly construed against the taxing authority and liberally in favor of the entity sought to be held." *Bullock v.*

(Vernon 1992); TEX. REV. CIV. STAT. ANN. Volume 20A Disposition Table (Vernon 1969).

Marathon Oil Co., 798 S.W.2d 353, 357 (Tex. App. – Austin 1990, no writ); *Bullock v. Statistical Tabulation Corp.*, 549 S.W.2d 166, 169 (Tex. 1977).

The Comptroller regulations in effect during the audit year indicated that Lawrence was *not* doing business in Texas. At the commencement of the audit year, the Comptroller's regulations provided: "A corporation is 'transacting' or 'doing' business in Texas when it is transacting some substantial part of its ordinary business in Texas." See Comptroller Ruling No. 026.02.12.016. The rule further stated that "the Texas Business Corporation Act, Art. 8.01, provides a non-exhaustive list of activities which do not constitute transacting business in the State." Article 8.01B of the Business Corporation Act excluded the following corporate activities from transacting business in the State:

> (2) Holding meetings of its directors or shareholders or carrying on other activities concerning its internal affairs;
>
> (3) Maintaining bank accounts;
>
> . . . .
>
> (5) Voting the stock of any corporation which it has lawfully acquired.

TEX. BUS. CORP. ACT art. 8.01B (Vernon 1980). In 1991, after the audit year, the Texas Supreme Court declared that this link to the Business Corporation Act was inconsistent with the intent of the Tax Code. *Sharp v. House of Lloyd, Inc.*, 815 S.W.2d 245, 247 (Tex. 1991). Of course, Lawrence could not have known about this decision to order its affairs in 1983 and 1984.

During the audit year, the Comptroller regulations were revised to provide that a holding company must have a principal place of business in Texas *and* manage or provide services for its subsidiaries.

> (14) Holding companies. Maintaining of a corporation's principal place of business in Texas to manage and direct, and/or perform services for subsidiaries or investee corporations.

See 8 Tex. Reg. 3236 (1983), adopting 34 Tex. Admin. Code § 3.406.

Application of the Law to the Facts

Under the circumstances in this case, Lawrence Industries did not have fair notice or warning that it would be subject to franchise taxation and the resulting tax was not fairly apportioned to the commerce carried on in the State. The Texas franchise tax statute was very general and did not explicitly state that Lawrence's conduct constituted doing business in the State.

Furthermore, during the audit year, the ambiguity appeared to have been resolved in the corporation's favor, by the franchise tax regulations which linked "doing business" in the Tax Code to "transacting business" in the Business Corporation Act. The Business Corporation Act specifically stated that shareholder and director meetings did not constitute transaction of business in the State. Even after the regulations were changed in the middle of the audit year, the regulations indicated that a holding company must have a principal place of

business in Texas *and* manage or provide services for its subsidiaries.

The auditor's notes, prepared during the course of the audit, indicated that the Comptroller's chance of winning a "doing business" determination was "difficult if not doubtful," demonstrating the ambiguity even within the Comptroller's Office. Plaintiff's Exh. 11. In fact, the Comptroller's Audit Manual stated that holding meetings of directors and shareholders "*do not* constitute 'doing business' in Texas for taxation purposes." Plaintiff's Exh. 13 at 24 (emphasis original). See Statement of Facts at 122-124.

Lawrence relied on the Comptroller's own regulations, which linked the franchise tax statute to the Business Corporation Act, and indicated that shareholders and directors' meetings would not constitute doing business for franchise tax purposes. Statement of Facts at 96-97. Blair Nelson, the tax manager for Lawrence (Statement of Facts at 83), testified:

> Q: (Mr. Langenberg) Did you have any reason to believe that you were going to be subject to franchise taxation?
>
> A: (Mr. Nelson) No, I was very surprised and shocked.
>
> Q: Okay. Why?
>
> A: Well, because my determination from everything I could read at the time and had done at the time, background and knowledge of the company's activities, was that it definitely did not do business in Texas.

Q: Okay. And explain some of the factors that went into your conclusion?

A: Well, I reviewed the various and sundry Texas law and comptroller's rulings and also Dailey's operations, any activity that – whatever activity – what Lawrence had, and determined that their only state that they were doing business in was Nevada.

Q: Okay. And could you be a little bit more specific about the activities or absence of activities that went into your evaluation?

A: Well, the only activities that I could recall and that I found out that the company was doing in Texas was they had some directors meetings and I believe shareholders meetings in Texas and they had a bank account in Texas, and that under – those things were specifically referred to as not causing a company to be doing business in Texas. Everything else they did was through the operation in Battle Mountain.

Statement of Facts at 87-88.

If the corporation had received fair notice, it could have easily avoided or minimized its tax liability by 1) holding its directors' meeting in another state, 2) transferring its interest bearing bank accounts to a non-Texas bank, thereby eliminating all Texas receipts, or 3) receiving a substantial dividend from its subsidiary, which would have been treated as a non-Texas receipt. Statement of Facts at 99-100. However, Lawrence did not receive fair notice, and as a result, incurred a half million dollar franchise tax liability based on $48,039 of interest

income from a Texas bank. See Plaintiff's Exhibit 6; Statement of Facts at 90. This assessment does not comport with due process and far exceeds the benefits, opportunities or protections afforded Lawrence by the State of Texas.

CONCLUSION

For these reasons, Petitioner requests the Court to grant this petition for writ of certiorari.

Respectfully submitted,

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APPENDIX

NO. 91-17719

LAWRENCE INDUSTRIES, INC. PLAINTIFF,	§	IN THE DISTRICT
V.	§	COURT OF
JOHN SHARP, COMPTROLLER OF PUBLIC ACCOUNTS OF THE STATE OF TEXAS; KAY BAILEY HUTCHISON, TREASURER OF THE STATE OF TEXAS; AND DAN MORALES, ATTORNEY GENERAL OF THE STATE OF TEXAS, DEFENDANTS.	§	TRAVIS COUNTY, TEXAS
	§	201ST JUDICIAL DISTRICT

Judgment

A non-jury trial on the merits was held on August 2, 1993 before the Honorable Bill Black, presiding judge. Plaintiff is Lawrence Industries, Inc. and Defendants are John Sharp, Comptroller of Public Accounts of the State of Texas, Martha Whitehead, successor-in-office to Kay Bailey Hutchison, Treasurer of the State of Texas, and Dan Morales, Attorney General of the State of Texas.

The Court has jurisdiction of the parties according to chapter 112 of title 2 of the Texas Tax Code. The Court has jurisdiction over the subject matter identified in Lawrence Industries' October 8, 1991 protest letter accompanying its franchise tax audit payment for report years

1985-1987. The Court does not have subject matter jurisdiction over the following issues: (1) estoppel; (2) Commerce Clause fair relation and fair apportionment; or (3) state and federal due process.

On August 2, 1993, pursuant to Rule 165 of the Texas Rules of Civil Procedure, Lawrence Industries abandoned the following claims appearing in its First Amended Petition: (1) equal and uniform taxation, (2) retroactivity, and (3) refunds for the 1986 and 1987 report years. Lawrence Industries also stipulated on the record that it was present and doing business in Texas during the 1986 and 1987 report years.

Based upon the evidence, legal authorities, and stipulations, the Court ORDERS that Plaintiff, Lawrence Industries, Inc., shall take nothing from Defendants as to franchise tax and interest paid under protest for report years 1985-1987. Defendant Martha Whitehead, Treasurer of the State of Texas, is ORDERED to transfer $837,681.31, plus statutory pro rata interest, from the suspense account to the appropriate state fund.

The Court ORDERS Plaintiff to pay Defendants' costs of court in the amount of $1,019, 45.

This judgment disposes of all claims, issues, and parties in this law suit. Relief not granted is denied.

Signed on September 10, 1993.

/s/ William C. Black
Judge Bill Black

NO. 91-17719

LAWRENCE INDUSTRIES, INC. PLAINTIFF,	§	IN THE
	§	DISTRICT
V.	§	COURT OF
	§	
JOHN SHARP, COMPTROLLER OF PUBLIC ACCOUNTS OF THE STATE OF TEXAS; KAY BAILEY HUTCHISON, TREASURER OF THE STATE OF TEXAS; AND DAN MORALES, ATTORNEY GENERAL OF THE STATE OF TEXAS, DEFENDANTS.	§	TRAVIS
	§	COUNTY, TEXAS
	§	
	§	
	§	
	§	201ST JUDICIAL
	§	DISTRICT
	§	

Findings of Fact And Conclusion Of Law

The Court files its findings of fact and conclusions of law pursuant to Rule 297 of the Texas Rules of Civil Procedure and the September 23, 1993 request of Plaintiff, Lawrence Industries, Inc.

I.

Findings Of Fact

1. Plaintiff, Lawrence Industries, Inc. is a Delaware corporation with a headquarters and principal place of business in Texas.

2. Lawrence Industries, Inc. does business in Texas.

3. Lawrence Industries, Inc. has substantial physical presence in Texas.

4. Defendant Comptroller of Public Accounts conducted a franchise tax audit of Lawrence Industries, Inc. for report periods 1985-1987 (covering Lawrence's accounting years May 1, 1983 through April 30, 1986), and assessed a deficiency.

5. A trial on August 2, 1993, pursuant to Rule 165 of the Texas Rules of Civil Procedure, Lawrence Industries abandoned the following claims in its First Amended Petition:

(a) equal and uniform taxation;

(b) retroactivity; and

(c) franchise tax refunds for the 1986 and 1987 report years.

6. At trial on August 2, 1993, Lawrence Industries stipulated on the record that it was present and doing business in Texas during the 1986 and 1987 franchise tax report years.

7. Defendants' costs of court are $1,019.45.

8. The total tax and interest to be transferred from the state protest suspense account to the appropriate state fund is $837,681.31, plus statutory pro rata interest.

II.

Conclusions Of Law

1. The Court has jurisdiction of the parties according to chapter 112 of title 2 of the Tax Code. TEX. TAX CODE ANN. §§ 112.051-112.053 (West 1993).

2. The Court has jurisdiction over the subject matter identified in Lawrence Industries' October 8, 1991 protest

letter accompanying its franchise tax audit payment for report years 1985-1987.

3. The Court does not have subject matter jurisdiction over the following issues:

(a) estoppel;

(b) Commerce Clause fair relation;

(c) Commerce Clause fair apportionment;

(d) state constitutional due process; or

(e) federal constitutional due process.

4. Lawrence Industries does business in Texas and is subject to the Texas franchise tax within the meaning of TEX. TAX CODE ANN. § 171.001 (West 1993).

5. Lawrence Industries has substantial physical presence in Texas.

6. Lawrence Industries has federal Commerce Clause nexus with Texas.

7. Comptroller franchise tax rule 3.406 (1986) and 3.406 (1987) are valid, and are consistent with the Tax Code.

8. Article 8.01 of the Texas Business Corporation Act does not control the determination of whether a corporation does business in Texas within the meaning of the Franchise Tax Act, TEX. TAX CODE ANN. ch. 171.

SIGNED on October 13th, 1993.

/s/ William C. Black
JUDGE WILLIAM C. BLACK

LAWRENCE INDUSTRIES, INC., Appellant,

v.

John SHARP, Comptroller of Public Accounts of the State of Texas; Martha Whitehead, Successor in Office to Kay Bailey Hutchison, Treasurer of the State of Texas; and Dan Morales, Attorney General of the State of Texas, Appellees.

No. 3-94-007-CV.

Court of Appeals of Texas, Austin.

Dec. 21, 1994

Rehearing Overruled Feb. 15, 1995.

Corporation brought tax protest suit challenging franchise tax assessment. Following nonjury trial, the District Court, Travis County, 201st Judicial District, William C. Black, J., entered judgment against corporation, which appealed. The Court of Appeals, Jones, J., held that: (1) evidence supported determination that corporation was "doing business" in state for franchise tax purposes, and (2) corporation had sufficient nexus with state to satisfy due process requirements.

Affirmed.

Ray Langenberg, Scott, Douglass & Luton, Austin, for appellant.

Dan Morales, Atty. Gen., Ms. Christine Monzingo, Asst. Atty. Gen., Taxation Div., Austin, for appellees.

Before POWERS, JONES and KIDD, JJ.

JONES, Justice.

Appellant Lawrence Industries, Inc. ("Lawrence") brought a tax protest suit against the Comptroller and other statutory defendants, appellees, to recover assessed franchise taxes. Tex.Tax Code Ann. § 112.053 (West 1992) (hereinafter "Tax Code"). Following a nonjury trial, the trial court rendered judgment for the Comptroller. Lawrence appeals, asserting that it was not doing business in Texas and did not have sufficient constitutional nexus with the state to subject it to franchise tax. We will affirm.

FACTUAL AND PROCEDURAL BACKGROUND

Lawrence is a holding company incorporated in Delaware in 1981. A closely held corporation, Lawrence owns stock in a group of subsidiaries, principally Dailey, Inc., that manufacture and rent oil field equipment. In 1981 Lawrence applied for and received a certificate of authority to do business in Texas. After filing its first franchise tax return in 1982, Lawrence withdrew the certificate in 1983. Following a franchise tax audit covering May 1, 1983, through April 30, 1986, the Comptroller concluded that Lawrence was doing business in the state, subjecting it to franchise tax liability of $837,681.31 for the three reporting years. *See* Tax Code § 171.001(a)(1). After an unsuccessful administrative appeal of this assessment, Lawrence paid the tax under protest. As required by statute, a letter outlining the reasons for the protest accompanied this payment. Tax Code § 112.051(b). In this letter Lawrence contended that it was "not doing business in Texas during the audited period" and "did

not have sufficient constitutional nexus with Texas to allow the imposition of the franchise tax."

Lawrence then filed a tax protest suit against the Comptroller to recover the assessment for the three-year audit period. Tax Code § 112.053. In a bench trial, Lawrence reasserted that it was not doing business in Texas within the provisions of the Tax Code and that it lacked sufficient constitutional nexus to the state to allow imposition of franchise taxes. Contrary to its initial position, however, Lawrence stipulated at trial that it was subject to the franchise tax for the last two audit years of the three-year period. The only issue at trial, therefore, was the propriety of the $502,740 tax assessment for the first audit year: May 1, 1983, through April 30, 1984 ("the audit year").[1]

At trial, Lawrence's case consisted primarily of the live testimony of William Sutton, an officer of Lawrence. Sutton testified that during the audit year Lawrence had its principal place of business in Nevada and that Lawrence was merely a holding company created for estate-planning purposes. In stark contrast, the Comptroller's case consisted of numerous documents that tended to show that Lawrence's principal place of business was Texas and that Lawrence managed and directed at least some of the activities of its subsidiaries. The court rendered judgment for the Comptroller.

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[1] Lawrence does not challenge the actual calculation of the tax, which was based on a percentage of Lawrence's business receipts from dividends and interest from its Texas subsidiaries.

Following a timely request, the trial court filed findings of fact and conclusions of law. In its first three findings of fact, the court found that Lawrence: (1) "is a Delaware corporation with a headquarters and principal place of business in Texas;" (2) "does business in Texas;" and (3) "has substantial physical presence in Texas." In addition to these factual findings, the trial court's conclusions of law state that Lawrence "does business in Texas and is subject to the Texas franchise tax within the meaning of Tex.Tax Code Ann. § 171.001" and "has federal Commerce Clause nexus with Texas." Further, the court concluded that it did not have subject matter jurisdiction over Lawrence's constitutional due process claims. Lawrence appeals, contending in two points of error that it was not doing business in Texas and lacked constitutional nexus with the state.

DOING BUSINESS IN TEXAS

Appellant's first point of error simply states: "Lawrence was not doing business in Texas." Lawrence's brief does not indicate whether this is a challenge to the trial court's fact finding or to its legal conclusion. When questioned during oral argument, and later in a post-submission letter brief, Lawrence adopted the position that "doing business" is a question of law for the court, requiring no deference to the trial court's express or implied fact findings. The Comptroller, on the other hand, maintains that Lawrence is actually challenging adverse determinations of fact made by the trial court, making this point of error essentially a sufficiency-of-the-evidence point. We begin with this threshold issue.

A. Factual or Legal Question

Because a factual finding that a company is "doing business" in a state often has direct legal consequences, it has sometimes been tossed into the imprecise category of a "mixed question of law and fact." *See Harris v. Columbia Broadcasting Sys., Inc.*, 405 S.W.2d 613, 616 (Tex.Civ.App. – Austin 1966, writ ref'd n.r.e.); *Chicago, R.I. & Pac. Ry. Co. v. Neil P. Anderson & Co.*, 130 S.W. 182, 183 (Tex.Civ.App.1910), *rev'd on other grounds*, 105 Tex. 1, 141 S.W. 513 (1911). However, it is possible to describe the factual and legal components of "doing business" with greater clarity.

The determination of whether a company is "doing business" in a state is inherently a factual inquiry. *See Ramsey v. Investors Diversified Servs., Inc.*, 248 S.W.2d 263, 266-67 (Tex.Civ.App. – Austin 1952, writ ref'd n.r.e.); 19 C.J.S. *Corporations* § 907 (1990); 36 Am.Jur.2d *Foreign Corporations* § 317 (1968). The fact-finder, of course, has the duty to resolve any conflicts in the evidence to determine the actual conduct of the corporation. *See Blackwood v. Tom Benson Chevrolet Co.*, 702 S.W.2d 732, 733 (Tex.App. – San Antonio 1985, no writ); *Mediacomp, Inc. v. Capital Cities Communication Inc.*, 698 S.W.2d 207, 211 (Tex.App. – Houston [1st Dist.] 1985, no writ). Once the particular facts and circumstances of a case are resolved, these must be applied against the backdrop of the applicable statute. *See* 36 Am.Jur.2d *Foreign Corporations* § 317 (1968).

When there is no factual dispute as to a company's activities, the question of "doing business" is, for all intents and purposes, a legal question. This is because the true legal issue (whether a company is subject to paying

franchise taxes) depends primarily on the answer to a single general factual determination (whether the company is doing business in the state). Thus, if a trial court finds on the basis of undisputed facts that a company is doing business in the state, this usually leads directly to a legal conclusion that the company is subject to paying franchise taxes, which is reviewable by a court of appeals for its correctness. *See Bullock v. House of Lloyd, Inc.*, 797 S.W.2d 133, 134 (Tex.App. – Austin 1990) (appellate review of trial court judgment made on stipulated facts), *rev'd sub nom. Sharp v. House of Lloyd, Inc.*, 815 S.W.2d 245 (Tex.1991); *Ramsey*, 248 S.W.2d at 266-67; *see also Westech Eng'g, Inc. v. Clearwater Constructors, Inc.*, 835 S.W.2d 190, 196 (Tex.App. – Austin 1992, no writ) ("The trial court's conclusions of law are always reviewable."). Likewise, our own legal conclusion on undisputed facts that a company is "doing business" is reviewable by the supreme court. *See Sharp v. House of Lloyd, Inc.*, 815 S.W.2d 245, 246 (Tex.1991); *S.R. Smythe Co. v. Fort Worth Glass & Sand Co.*, 105 Tex. 8, 142 S.W. 1157, 1157 (1912) ("The sole question for decision is whether under the facts and circumstances presented, which are practically uncontroverted, the plaintiff transacted business in this state. . . . ").

However, when there is a dispute about the relevant characteristics or conduct of a company, a finding that the company is "doing business" presents a slightly different situation. In this context, it becomes clearer that the finding of "doing business" is really one of "ultimate" fact. A finding of ultimate fact is the product of logical reasoning and inference from more specific, evidentiary facts, i.e., those "basic" or "underlying" facts that are the direct

product of the truth-finding function of the fact-finder. *Wilson v. Metcalf*, 257 S.W.2d 855, 858 (Tex.Civ.App. – Amarillo 1953, writ ref'd n.r.e.); 89 C.J.S. *Trial* § 648 (1955). This is similar to the relationship between findings of basic or underlying fact and findings of ultimate fact made by an administrative agency.[2] *See* Administrative Procedure Act, Tex.Gov't Code Ann. § 2001.141 (West 1995). *See generally* John Powers, *Judicial Review of the Findings of Fact Made by Texas Administrative Agencies in Contested Cases*, 16 Tex.Tech L.Rev. 475, 476-79 (1985).

When a challenge is made to an ultimate factual finding, or to the underlying basic facts that support it, we must address it as we would any challenge to the sufficiency of the evidence to support a fact finding. *See De Llano v. Moran*, 160 Tex. 490, 333 S.W.2d 359, 360-61 (1960); *cf. Posner v. Dallas County Child Welfare Unit*, 784 S.W.2d 585, 587 (Tex.App. – Eastland 1990, writ denied) (unchallenged ultimate fact findings are binding). If there is some evidence of a substantial and probative character to support the trial court's findings of fact – i.e., if there is enough evidence that reasonable minds could differ – such findings are controlling and will not be disturbed,

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[2] In the administrative agency context, the distinction between ultimate facts and underlying or basic facts is recognized by statute. *See* Tex.Gov't Code Ann. § 2001.141(d) (West 1995). Outside of that context, the distinction is not often discussed in Texas, because trial courts are not required to file findings of underlying fact. *See Harding v. Harding*, 461 S.W.2d 235, 236 (Tex.Civ.App. – San Antonio 1970, no writ). As a general concept, however, the distinction is valid. We use it here simply to add clarity to our discussion of why the "doing business" issue is, at its essence, a question of fact.

even though the appellate court might have reached a different decision had it been the original fact-finder. *Ray v. Farmers' State Bank*, 576 S.W.2d 607, 609 (Tex.1979); *Central Power & Light Co. v. Bullock*, 696 S.W.2d 30, 33 (Tex.App. – Austin 1984, no writ); *Nelson v. Jordan*, 663 S.W.2d 82, 86 (Tex.App. – Austin 1983, writ ref'd n.r.e.). This is precisely the type of challenge presented in this appeal.

B. Lawrence's Factual Challenge

Lawrence challenges the finding of ultimate fact that it was doing business in Texas during the audit year. The gist of its argument is twofold: (1) its principal place of business is in Nevada, not Texas, and (2) it did not manage and control its subsidiaries. Both of these are underlying factual components of "doing business."

The trial court specifically found that Lawrence had its principal place of business in Texas.[3] The evidence surrounding Lawrence's principal place of business during the audit year was conflicting. Sutton testified that Lawrence's principal place of business was Nevada. The testimony of this interested witness was controverted, however, by Lawrence's own Delaware franchise tax return for the audit year, which lists Conroe, Texas, as

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[3] The trial court made a separate finding of fact that Lawrence's principal place of business was in Texas. Lawrence's brief does not contain a point of error directly challenging this finding. Rather, its argument concerning "doing business" includes a section attacking the finding and directing the court to the disputed testimony described below.

Lawrence's "principal place of business outside of Delaware." Lawrence attempted to contest this evidence with testimony of another interested witness, Blair Nelson, the corporate official who actually signed the Delaware franchise tax return. Nelson testified that the Conroe address actually belonged to Dailey, not Lawrence, and had "no real reflection on whether you're doing business or not." Other testimony, however, showed that all of Lawrence's books, records, directors, and officers were in Texas. In addition, Lawrence's own board minutes from November 30, 1983, begin with a "waiver of notice" reciting that all the directors of Lawrence consented to the meeting "at the principal offices located at 3663 North Belt East, Suite 300, Houston, Texas." When the court found that Texas was Lawrence's principal place of business, it resolved these evidentiary conflicts against Lawrence. We cannot disturb this factual finding in light of the conflicting evidence. *Runnells v. Firestone*, 746 S.W.2d 845, 851 (Tex.App. – Houston [14th Dist.]), *writ denied per curiam*, 760 S.W.2d 240 (Tex.1988); *Belford v. Belford*, 682 S.W.2d 675, 677 (Tex.App. – Austin 1984, no writ).

All parties agree that Lawrence was a holding company. The Comptroller contends that Lawrence was doing business in Texas in part because it was, from its base in Texas, actively managing and directing the affairs of its subsidiaries. The primary evidence offered by the Comptroller for this management activity is the minutes from Lawrence's November 30, 1983, board meeting. These board minutes reflect that Lawrence: established company-wide goals, including financial planning; created an executive committee, composed of J.D. Lawrence and Sutton, to conduct company business; and, at Sutton's

request, engaged in "strategic planning" for the company.[4] As with the Delaware tax return, Lawrence attempted to explain away this document through testimony of one of the interested participants, Sutton himself. Sutton testified that this set of minutes, which he personally drafted and signed, was merely a duplicate set of minutes from the Dailey board meeting that "was just papering behind what Dailey was doing." Again, however, the trial court had the opportunity to view and compare both the documents and the trial testimony of Sutton and presumably concluded that the minutes more accurately reflected Lawrence's true business activity. Given the conflicting evidence and our standard of review, we must defer to this factual determination.

Aside from the board minutes, there were additional underlying facts bearing on the managing-and-directing issue. The evidence relevant to these facts was also contested. One of these underlying facts concerned the existence of a centralized cash management system. Deposition testimony from David Tighe established that all revenue from Lawrence and its subsidiaries flowed into a "cash management system," including a "concentration account" in Lawrence's name. Tighe initially testified that this system was in place as early as January 1984, placing it within the audit year. Later, he contradicted his own deposition testimony and stated it was not

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[4] Sutton admitted on cross-examination that the word "company" in the board minutes meant Lawrence and its subsidiaries.

in place until June 1984. Sutton also testified to the existence of the cash control policy, but dated it as of November 1984. In earlier testimony, however, Sutton had indicated that he had no personal knowledge of when the cash management system began and that Tighe would have a more detailed knowledge of the system. As with the board minutes, given the trial court's finding of ultimate fact that Lawrence was doing business in Texas, we must presume that the trial court resolved this underlying fact issue against Lawrence.

A similar scenario surrounds the construction of Lawrence's corporate headquarters at One Lawrence Center in Conroe. The Comptroller presented documentary evidence tending to show Lawrence's active participation in the project; Lawrence countered with the testimony of interested witnesses. We review this underlying fact issue following the same process as the others. The trial court was in a position to evaluate the weight and credibility of this evidence and presumably resolved the issue adversely to Lawrence.

All of these underlying facts concerning Lawrence's management of the subsidiaries were the subjects of disputed evidence. When the trial court made its finding of ultimate fact that Lawrence was doing business in Texas, we must presume that it resolved all conflicts in the underlying facts against Lawrence. *See Lindner v. Hill*, 691 S.W.2d 590, 592 (Tex.1985); Tex.R.Civ.P. 299. We cannot substitute our judgment for the trial court's on these factual determinations. Few propositions are more fundamental to appellate review than that great deference is given to fact findings made by the trier of fact, who had the opportunity to view the demeanor of the witnesses

and weigh their credibility. *See, e.g., McGalliard v. Kuhlmann*, 722 S.W.2d 694, 696-97 (Tex.1986); *Paul v. Perez*, 7 Tex. 338, 346 (1851). Given our unwillingness – indeed, our inability – to overturn the trial court's express and implied factual findings, the factual setting that emerges is a corporation that has its principal place of business in Texas and that manages and directs activities of its subsidiaries.

C. The Mixed Fact/Law Question

The next question is whether a holding company with its principal place of business in Texas that manages and directs at least some of the affairs of its subsidiaries is "doing business" in Texas so as to be subject to franchise tax. Conceptually, this is actually a two-step process: (1) Do the underlying facts and the reasonable inferences that may be drawn therefrom logically support the ultimate facts found by the court? (2) Do those ultimate facts logically support the court's conclusions of law? For purposes of our discussion here, we roll these two questions into one.

While the Tax Code has gone through many incarnations, since 1941 the legislature has imposed a franchise tax on all corporations doing business in Texas. *House of Lloyd*, 815 S.W.2d at 246-47. The current Code imposes a franchise tax on "each corporation that does business in this state." Tax Code § 171.001(a)(1). The phrase "does business" is not defined in the Code. However, the supreme court directly addressed the meaning of "doing business" for purposes of the franchise tax in *House of Lloyd*. In *House of Lloyd*, the supreme court invalidated a

long-standing comptroller rule that erroneously limited "doing business" for franchise tax purposes to the definition of "transacting business" in the Texas Business Corporation Act. The court noted that the legislature intended to expand the state's authority to tax corporations that were incorporated elsewhere but did business here. *House of Lloyd*, 815 S.W.2d at 247. Interpreting the legislature's intent, the court concluded that "doing business" means "conducting business activities in Texas." *Id.* While this decision post-dates Lawrence's audit year, it indicates that the phrase "doing business" in the statute is not ambiguous and basically means what it says: a foreign corporation that conducts business in Texas is subject to paying franchise taxes.

Further guidance on what constitutes doing business for franchise tax purposes comes from the Comptroller's rules in place during the audit year. From 1975 through September 5, 1983, Comptroller regulations provided that "a corporation is 'transacting' or 'doing' business in Texas when it is transacting *some substantial part* of its ordinary business in Texas." 34 Tex.Admin.Code ("TAC") § 3.406 (1975) (emphasis added). Effective September 5, 1983, the Comptroller changed the regulation to provide that a corporation was doing business if it was "transacting *some part* of its ordinary business in Texas." 34 TAC § 3.406(b) (1983) (emphasis added). This revised regulation also identified specific activities that constituted doing business in the state. These included the following: "Holding companies. Maintaining of a corporation's principal place of business in Texas to manage and direct,

and/or perform services for subsidiaries or investee corporations." 34 TAC § 3.406(c)(14). Additionally, a corporation with its principal place of business in Texas is presumed to be doing business in the state. 34 TAC § 3.406(c)(15).

When placed against this backdrop, it is clear that a foreign holding company that has its principal place of business in Texas and that manages and directs the affairs of its subsidiaries is doing business in Texas and is subject to franchise tax. The legislative authorization to collect franchise taxes from foreign companies conducting business in Texas has been unchanged since 1941. The Comptroller's rules that existed during the audit period likewise indicate that this type of business activity would subject the company to tax. Even Lawrence has not seriously challenged that such a company is subject to tax. Rather, it simply contends it was not such a company. Given the trial court's resolution of the factual issues, however, its legal conclusion that Lawrence was subject to franchise tax for the audit year was not erroneous. We overrule Lawrence's first point of error.

CONSTITUTIONAL NEXUS

Lawrence's second point of error is that the "tax assessment violated due process." The Comptroller challenged the trial court's jurisdiction over this due process claim on the ground that the issue was not raised in its written protest letter. The Code requires that tax protests must be "in writing and must state fully and in detail each reason for recovering the payment." Tax Code § 112.051(b). Issues determined in the tax protest suit are

then "limited to those arising from the reasons expressed in the written protest as originally filed." Tax Code § 112.053(b). This requirement serves a twofold purpose: (1) allowing the Comptroller the first opportunity to determine the merits and validity of the protest; and (2) preventing the protestor from taking advantage by "changing horses" at trial. *See James v. Consolidated Steel Corp.*, 195 S.W.2d 955, 962 (Tex.Civ.App. – Austin 1946, writ ref'd n.r.e.).

Lawrence's protest letter included the following sentence: "Lawrence did not have sufficient constitutional nexus with Texas to allow imposition of the franchise tax." The trial court concluded that Lawrence had "federal Commerce Clause nexus with Texas"; the court also concluded, however, that it lacked subject matter jurisdiction over Lawrence's due process claim, presumably on the ground that it had not been adequately raised by the protest letter. Lawrence does not challenge the trial court's conclusion that it had Commerce Clause nexus with Texas. Commerce Clause nexus requires a "substantial nexus" with a state. *Quill Corp. v. North Dakota*, ___ U.S. ___, ___, 112 S.Ct. 1904, 1913, 119 L.Ed.2d 91 (1992). In contrast, due process nexus is a proxy for notice and requires only minimum contacts. *Id.* The trial court's unchallenged conclusion that Lawrence had Commerce Clause nexus with Texas indicates it must have met the lesser threshold of due process nexus. *See id.* at ___ n. 7, 112 S.Ct. at 1914 n. 7 (suggesting that "every tax that passes contemporary Commerce Clause analysis is also valid under the Due Process Clause"). However, since the Supreme Court has admonished that the superior practice is to approach each issue separately, we independently

address the merits of the due process claim. *See id.* at ___, 112 S.Ct. at 1909.

The Comptroller argues that the phrase "constitutional nexus" could have meant either Commerce Clause nexus or Due Process Clause nexus and was therefore too indefinite to place the due process question at issue. We disagree. We think Lawrence's use of the phrase "constitutional nexus," although less than ideally definite, was sufficient to alert the Comptroller to the subject matter of the protest as required by the Tax Code, thereby giving the trial court jurisdiction over Lawrence's due process claim. We conclude, however, that Lawrence had sufficient nexus with the state to subject it to franchise tax.

The requirements of due process have been recently pronounced by the United States Supreme Court in *Quill:*

> Thus, at the most general level, the due process nexus analysis requires that we ask whether an individual's connections with a State are substantial enough to legitimate the State's exercise of power over him. We have, therefore, often identified 'notice' or 'fair warning' as the analytic touchstone of due process nexus analysis.

___ U.S. at ___, 112 S.Ct. at 1913.

The essence of Lawrence's argument is that it relied on the Comptroller's regulations linking the franchise tax statute to language in the Business Corporation Act stating that having shareholder and director meetings in the state did not constitute doing business in Texas. Lawrence once again directs us to the testimony of Blair Nelson, Lawrence's tax manager. Nelson testified that based on his review of "various and sundry Texas law

and comptroller's rulings," the only state Lawrence was doing business in was Nevada. This reliance, Lawrence argues, stripped it of fair notice of taxation.

However, constitutional due process does not hinge on either the language of old Comptroller rules or the opinion of Lawrence's tax manager, but on whether Lawrence's connections were "substantial enough to legitimate the State's exercise of power." *Quill*, ___ U.S. at ___, 112 S.Ct. at 1913. Based on the trial court's factual determinations, Lawrence was not merely a holding company that held director meetings in Texas, but a company that had its principal place of business in Texas. This alone provides sufficient "minimum contacts" with the state to meet the due process nexus requirement. Beyond this, the trial court found that Lawrence was actually transacting business in Texas, that is, managing and directing the affairs of its subsidiaries. To be sure, Lawrence continues to challenge these adverse factual findings. However, these determinations having been made on conflicting evidence, we cannot say that taxing a corporation that has its principal place of business in Texas and that is actually doing business in Texas violates due process protection. Point of error two is overruled.

CONCLUSION

Lawrence's appeal is fundamentally a challenge to various express and implied fact findings of the trial court. Unwilling to disturb these findings, we overrule both points of error. The judgment of the trial court is affirmed.

[seal] **THE SUPREME COURT OF TEXAS**
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RE: Case Number 95-0275
Style: LAWRENCE INDUSTRIES, INC.
v.
JOHN SHARP, COMPTROLLER OF PUBLIC ACCOUNTS OF THE STATE OF TEXAS, ET AL.

Dear Counsel:

Today, the Supreme Court of Texas denied the above referenced application for writ of error with the notation "Writ Denied".

Respectfully yours,

JOHN T. ADAMS, CLERK

BY: /s/ Michael C. Murphey
Michael C. Murphey,
Deputy Clerk